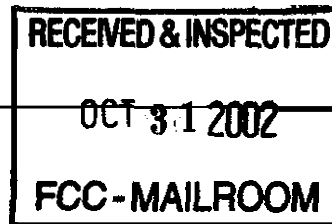




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DA 02-2925
October 31, 2002

**ENFORCEMENT BUREAU SEEKS COMMENTS ON SBC COMMUNICATIONS SECTION
272 COMPLIANCE BIENNIAL AUDIT REPORT IN CC DOCKET NO. 96-150**

Comments due: December 30, 2002

Pursuant to section 271 of the Communications Act of 1934, as amended ("Communications Act"), the Commission has authorized SBC Communications, Inc. ("SBC") to enter the in-region interLATA market in Texas, Kansas, and Oklahoma.¹ Section 272 of the Communications Act requires Bell Operating Companies to offer in-region, interLATA service through separate affiliates that comply with certain structural, nondiscrimination, and accounting safeguards. Section 272(d) requires a biennial compliance audit.² We have received the results of the biennial audit of SBC's first year of operations in Texas, Kansas, and Oklahoma. The audit report, which was submitted by Ernst and Young, LLP on December 17, 2001, includes: Report of Independent Accountants on Applying Agreed-Upon Procedures; SBC's Response to the Report of Independent Accountants; and Observation of the Joint Federal/State Oversight Team.

Section 272(d)(2) of the Communications Act requires that the results of the audit be made publicly available.³ Having resolved certain confidentiality issues concerning the audit report,⁴ we now release the attached audit report. In accordance with section 53.213(d) of the Commission's rules, interested parties

¹ 47 U.S.C. § 271.

² Application by SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region InterLATA Services in Texas, CC Docket No. 00-65, Memorandum Opinion and Order, 15 FCC Rcd 18354 (2000) (SBC Texas 271 Order); Joint Application by SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Kansas and Oklahoma, CC Docket No. 00-217, Memorandum Opinion and Order, 16 FCC Rcd 6237 (2001) (SBC Kansas/Oklahoma 271 Order).

³ 47 U.S.C. § 272(d).

⁴ 47 U.S.C. § 272(d)(2).

⁵ Accounting Safeguards Under the Telecommunications Act of 1996: Section 272(d) Biennial Audit Procedures, CC Docket No. 96-150, Memorandum Opinion and Order, 17 FCC Rcd 17012 (2002) (SBC Section 272 Confidentiality Order).

may file comments on the report with the Commission within 60 days.⁶ Accordingly, comments **are** due no later than December 30, 2002.

EX ***PART***E PRESENTATIONS

Pursuant to section 1.1206 of the Commission's rules, this proceeding will be conducted **as** a *permit-but-disclose* proceeding in which ex parte communications **are** permissible but subject to disclosure.⁷

FILING PROCEDURES

Interested parties may file comments on the biennial audit ~~report~~ using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies.⁸ Comments filed **through** the ECFS can be sent as an electronic file via the Internet to <<http://www.fcc.gov/e-file/ecfs.html>>. Generally, only one copy of an electronic submission must be filed. In completing the transmittal screen, commenters should include their full name, Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions for e-mail comments, commenters should send an e-mail to ecfs@fcc.gov, and should include the following words in the body of the message, "get form <your e-mail address.>" A sample form and directions will be sent in reply.

Parties who choose to file by paper must file an *original* and four copies of each filing. All filings must be sent to **the** Commission's Secretary, Marlene H. Dortch, Office of the Secretary, Federal Communications Commission, 445 12th Street, S.W., CY-B402, Washington, D.C. 20554.

Parties who choose to file by paper should also submit their comments on diskette. These diskettes should be submitted to: Ernestine Creech, Room 6-C317, Investigations and Hearings Division, Enforcement **Bureau**, 445 12th Street, S.W., Washington, D.C. 20554. Such **a** submission should be on a 3.5-inch diskette formatted in an IBM compatible format using Word or compatible software. The diskette should be accompanied by a cover letter and should **be** submitted in "**read** only" mode. The diskette should be clearly labeled with the commenter's name, proceeding (including the docket number, in this case CC Docket No. 96-150, **type** of pleading (comments), date of submission, and the name of the electronic file on the diskette. The label should also include the following phrase "Disk Copy -Not an Original." Each diskette should contain only one party's pleadings, preferably in **a** single electronic file. In addition, commenters must send diskette copies to the Commission's copy contractor, Qualex International, Portals II, 445 12 **Street**, SW, Room CY-B402, Washington, D.C. 20554.

⁶ 47 CFR. § 53.213(d).

⁷ 47 CFR. § 1.1206.

⁸ See Electronic Filing of Documents in Rulemaking Proceedings, 63 Fed. Reg. **24,121** (1998).

All filings must contain the docket or rulemaking number that appears in the caption of this proceeding. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or Overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail). The Commission's contractor, Vistrionix, Inc., will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, D.C. 20002. The filing hours at this location **are** 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of before entering the building. Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743. The filing hours at this location are 8 **am.** to 5:30 p.m. First-class U.S. Postal Service mail, Express Mail, and Priority Mail should be addressed to 445 12th Street, SW, Washington, D.C. 20554. All filings must contain the Docket Number, and must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission.

If you are sending this type of document or using this delivery method...	It should be addressed for delivery to...
Hand-delivered or messenger-delivered paper filings for the Commission's Secretary	236 Massachusetts Avenue, NE , Suite 110, Washington, DC 20002 (8:00 a.m. to 7:00 p.m.)
Commercial overnight mail (other than United States Postal Service Express Mail and Priority Mail)	9300 East Hampton Drive, Capitol Heights, MD 20743 (8:00 a.m. to 5:30 p.m.)
United States Postal Service first-class mail, Express Mail, and Priority Mail	445 12 th Street, SW Washington, DC 20554

⁹ See Public Notice, "FCC Announces New Filing Location for Paper Documents," **DA** 01-2919 (rel. December 14, 2001).

Parties are strongly encouraged to file comments electronically using the Commission's Electronic Comment Filing System (ECFS).

Copies of the biennial audit report (attached) and any subsequently filed documents in this matter may be obtained from the Commission's duplicating contractor, Qualex International, Portals 11, 445 12th Street, SW, Room CY-B402, Washington, DC, 20554, telephone (202) 863-2893, facsimile (202) 863-2898, or via e-mail qualexint@aol.com. Electronic versions of the report are also available on the FCC's Internet Home Page (<http://www.fcc.gov>) and through the Commission's Electronic Comment Filing System. To the extent that parties file electronic versions of comments, such filings also will be available on the FCC's Internet Home Page and through the Commission's Electronic Comment Filing System. Copies of the audit report (attached) and documents are also available for public inspection and copying during normal reference room hours at the Commission's Reference Center, 445 12th Street, S.W., CY-4257, Washington, D.C. 20554.

For further information, contact Hugh L. Boyle at (202) 418-7147 or Mika Savir at (202) 418-0384.

Action by the Chief, Enforcement Bureau

Report of Independent Accountants on Applying Agreed-Upon Procedures

To the Management of SBC Communications Inc.

We have performed the procedures enumerated in Appendix A, which were agreed to by management of SBC Communications Inc. (“SBC”) and the Joint Federal/State Oversight Team (“Joint Oversight Team”)’ (collectively, the “Specified Users”), solely to assist these specified parties in evaluating management’s assertion that SBC complied with the requirements of Section 272 of the Communications Act of 1934, as Amended (“Section 272 Requirements”),² during the period from July 10, 2000 to July 9, 2001 (“the Engagement Period”). This engagement was performed in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the Specified Users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described in Appendix A either for the purpose for which this report has been requested or for any other purpose.

The procedures performed and the results obtained are documented in Appendix A. These procedures and the results are not intended to be an interpretation of any legal or regulatory rules, regulations, or requirements.

We were not engaged to, and did not, conduct an examination, the objective of which would be the expression of an opinion on SBC’s compliance with the Section 272 Requirements. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

The Specified Users of this report determined and agreed to the procedures to be performed in this engagement, including agreement on the information that was to be obtained as a result of executing those procedures and the information that was to be included in the report. The findings within this report represent the results obtained from performing those procedures. As provided for in the regulations, the Joint Oversight Team as a Specified User prepared Attachment B-1, *Comments of the Joint Oversight Team for the SBC Communications Inc. Section 272 Agreed-Upon Procedures Engagement*, describing items in addition to the findings

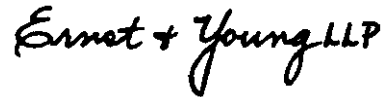
¹ The “Joint Federal/State Oversight Team” is comprised of staff members from 11 state regulatory agencies and the Federal Communications Commission (“FCC”). SBC operates in the following 13 states: Arkansas, Kansas, Missouri, Oklahoma, Texas, California, Nevada, Illinois, Indiana, Michigan, Ohio, Wisconsin, and Connecticut. Representatives from Nevada and Michigan did not participate with the Joint Federal/State Oversight Team.

² These requirements are contained in 47 U.S.C. Section 272(b), (c), and (e) of the Communications Act of 1934, as Amended (the “Act”), and in 47 C.F.R. Section 53.209(b) of the Federal Communications Commission’s rules and regulations.

To the Management of SBC Communications Inc.

resulting from the application of the agreed-upon procedures that the Joint Oversight Team believes should also be disclosed in this report. SBC as a Specified User prepared Attachment B-2, *SBC Communications Inc.'s letter dated December 14, 2001 and SBC Management Response*, providing additional information regarding findings in the report. We were not engaged to and did not perform any procedures related to Attachments B-1 and B-2. However, we have provided Attachment B-3, *Comments of Ernst & Young for the SBC Communications Inc. Section 272 Agreed-Upon Procedures Engagement*, which contains additional information regarding the Joint Oversight Team's comments.

This report is intended solely for the information and use of management of SBC and the Joint Federal/State Oversight Team, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.



December 17, 2001

APPENDIX A

Results of Agreed-Upon Procedures

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OBJECTIVE IX. Determine whether or not the BOCs and an affiliate subject to Section 251(c) of the Act have made available facilities, services, or information concerning its provision of exchange access to other providers of interLATA services **on** the same terms and conditions **as** they have to their affiliate required under Section 272 that operates in the same market. 31

OBJECTIVE X. Determine whether or not the BOCs and an affiliate subject to Section 251(c) of the Act have charged their separate affiliate under Section 272, or imputed to themselves (if using the access for their provision of their **own** services), an **amount** for access to their telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service. 34

OBJECTIVE XI. Determine whether or not the BOCs and an affiliate subject to Section 251(c) of the Act have provided **any** interLATA facilities or services to their interLATA affiliate and made available such services or facilities to all carriers at the same rates and **on** the same terms and conditions, and allocated the associated costs appropriately. 38

Attachment A-1; Objective I, Procedure 3
Section 272 Affiliates Employees and Departments by Location

Attachment A-2; Objective I, Procedure 5
Suppliers Providing Operations, Installation, and Maintenance Over
Transmission and Switching Facilities

Attachment A-3; Objective **III**, Procedure 6
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Attachment A-4; Objectives V, VI, Procedure 6
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- Attachment A-5b; Objective VII, Procedure 5
Comparison of Billing & Collection Rates ACI and Unaffiliated Carriers
- Attachment A-5c; Objective VII, Procedure 5
Comparison of Rates Charged by SBC BOCs to Section 272 Affiliates to
Rates Charged by SBC BOCs to Other Unaffiliated Entities
- Attachment A-6; Objective VIII, Procedure 2
Section 272 (e)(1) Performance Measurements Business Rules
- Attachment A-7; Objective VIII, Procedure 3
Performance Measure Differences
- Attachment A-Sa; Objective IX, Procedure 3
USOCs and Class of Service Codes Billed to Section 272 Affiliates in
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- Attachment A-Sb; Objective IX, Procedure 3
Exchange Access USOC Rate Comparison Differences
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- Attachment B-1; Comments of the Joint Oversight ~~Team~~ for the SBC
Communications Inc. Section 272 Agreed-Upon Procedures Engagement
- Attachment B-2; SBC Communications Inc.'s Letter Dated December 14,
2001 and SBC Management Response
- Attachment B-3; Comments of Emst & Young for the SBC Communications
Inc. Section 272 Agreed-Upon Procedures Engagement

APPENDIX A

Results of Agreed-Upon Procedures

OBJECTIVE I. Determine whether the separate affiliate required under Section 272 of the Act has operated independently of the BOCs.

1. Inspected the certificates of incorporation, bylaws, and articles of incorporation of each Section 272 affiliate³ and noted that the inspected documents stated that each Section 272 affiliate was established as a corporation separate from the SBC BOCs⁴.
2. Obtained and inspected the corporate entities' organizational charts of the SBC BOCs, Section 272 affiliates, and SBC Communications Inc. and confirmed with legal representatives of the BOCs, Section 272 affiliates, and SBC Communications Inc. the legal, reporting, and operational corporate structure of the Section 272 affiliates. Noted that the inspected organizational charts and written confirmations from legal representatives stated that SBCS is a wholly owned subsidiary of SBC Communications Inc., and ACI is a wholly owned subsidiary of Ameritech Corporation, which in turn is 100% owned by SBC Communications Inc.
3. Obtained the functional organizational chart for each Section 272 affiliate as of March 31, 2001 (the end of the ninth month of the Engagement Period). Noted that the charts did not include a summary of the number of employees by department and location. SBC was unable to recreate the March 31, 2001 organization chart and summary requested because the organizational charts are updated monthly and the March 31, 2001 information was not retained. Therefore, obtained the functional organizational detail which listed the number of employees, street addresses where employees were located, and departmental functions for each location as of August 1, 2001, as shown in Attachment A-I.

³ The words "Section 272 affiliates" used throughout this representation refer to the following companies, collectively, Southwestern Bell Communications Services, Inc. ("SBCS") doing business as Southwestern Bell Long Distance ("SBCLD") and Ameritech Communications, Inc. ("ACI").

⁴ The words "SBC BOCs" refer to the SBC operating telephone companies, operating as incumbent local exchange carriers ("ILECs"), and include the following: Illinois Bell Telephone Company; Indiana Bell Telephone Company, Incorporated; Michigan Bell Telephone Company; Nevada Bell; The Ohio Bell Telephone Company, Pacific Bell Telephone; Southwestern Bell Telephone Company ("SWBT"); and Wisconsin Bell, Inc. Although The Southern New England Telephone Company ("SNET") and The Woodbury Telephone Company are not BOCs as defined by the Act, for purposes of the Biennial Audit, they are treated as SBC BOCs with respect to the structural, transactional, and nondiscriminatory requirements of Sections 212 (b) and 272 (e) to the extent they are included in Objectives I through XI.

4. Obtained, from the Section 272 affiliates, a list and description of services rendered to the Section 272 affiliates during the first nine months of the Engagement Period by the SBC BOCs, by other affiliates, and by unaffiliated companies. Noted that the lists included the location of both the providing and receiving entity for all services involving operations, installation, and maintenance (“OI&M”).
5. By review of the listings obtained in procedures 3 and 4 above and SBC representation, noted that none of the Section 272 affiliates obtained OI&M services for transmission and switching facilities from the SBC BOCs or any other affiliated entity. However, noted that the Section 272 affiliates obtained OI&M services from unaffiliated entities. Obtained a listing of OI&M services provided to the Section 272 affiliates by unaffiliated entities. Noted that this listing included the location of the service provider and the primary location where the Section 272 affiliate received the service. The listing indicated that all services were provided to facilities owned by the Section 272 affiliates. Attachment A-2 lists the unaffiliated entities providing OI&M service to the Section 272 affiliates during the Engagement Period.
6. SBC represented that the SBC BOCs did not provide research and development (“R&D”) activities to the Section 272 affiliates for the first nine months of the Engagement Period. SBC represented that the SBC BOCs did not offer or perform any R&D services on behalf of the Section 272 affiliates or unaffiliated entities during the Engagement Period.
7. Obtained the balance sheet of each Section 272 affiliate as of March 31, 2001 and a detailed listing of all fixed assets (“listing”) including capitalized software. Noted that the listing agreed to the balance sheet with the exception of rounding differences of \$756 and \$781 for SBCS and ACI, respectively. Noted that the detailed fixed asset listing for SBCS and ACI totaled \$39,791,754 and \$66,676,219, respectively.

Verified by observation that the listings obtained above, which included 480 assets for SBCS and 2,735 assets for ACI, included information in the five required fields of data: description, location of each item, date of purchase, price paid and recorded, and from whom the asset was purchased or transferred. Noted that all 16,075 required data fields were populated except for 119 assets of SBCS and 337 assets of **ACI** that did not include information in one data field, “from whom the asset was purchased or transferred.”

Determined which fixed assets related to transmission and switching facilities, including capitalized software, and the land and buildings where those facilities are located by reviewing the descriptions of the assets on the listing and noting which general ledger account numbers included transmission and switching facilities. Obtained verification from SBC that the general ledger account numbers identified representing all transmission and switching facilities, including capitalized software, and the land and buildings where **those** facilities were located as of July 9, 2001 were included in the

listings. The population of the transmission and switching facilities fixed assets is summarized below.

Table 1 – **Summary** of Transmission & Switching Facilities Fixed Assets as of March **31**, 2001

<u>Section 272 Affiliate</u>	<u>Total Number of Items</u>	<u>Total Fixed Asset Balance</u>
ACI	757	\$ 28,991,754
SBCS	169	22,941,521
Total	<u>926</u>	<u>\$ 51,933,275</u>

Of the population of transmission and switching facilities fixed assets described above, randomly selected 100 items and inspected documentation, which revealed ownership of 97 of the 100 items selected. Noted per inspection of invoices that none of the 97 items selected were purchased jointly by the Section 272 affiliate and the SBC BOCs. SBC was unable to prove ownership of three items selected from ACI totaling \$33,799.32. SBC explained that the reasons for the inability to locate documentation supporting ownership of these items were due to the age of the asset (four to six years) and/or the fixed asset system conversions that have occurred since the assets were acquired.

OBJECTIVE II. Determine whether the separate affiliate required under Section **272** of the Act has maintained books, records, and accounts in the manner prescribed by the Commission that are separate from the books, records, and accounts maintained **by** the BOCs.

1. Obtained the general ledger of each Section 272 affiliate as of March 31, 2001 and matched the title on the general ledger with the name of the affiliate on the certificate of incorporation and noted that a separate general ledger was maintained. Reviewed the general ledgers for special codes to link the Section 272 affiliates to the SBC BOCs and noted none.
2. Obtained and documented the accounting procedures and policies utilized by each Section 272 affiliate during the Engagement Period. This documentation includes an understanding of the accounting systems, processes, transaction flows, and control points affecting revenue, accounts receivable, cash receipts, purchasing, accounts payable, cash disbursements, payroll, fixed assets, and recording of affiliate transactions.

Noted that each Section 272 affiliate maintained a separate general ledger from the SBC BOCs and obtained accounting support from SBC Services, Inc., an affiliated central

services organization. Noted that SBC Services, Inc. establishes accounting policies and procedures for most SBC affiliates (including Section 272 affiliates) and maintains the Section 272 affiliates' general ledgers and other financial accounting systems in accordance with an affiliate agreement. These accounting systems include billing and collections, purchasing, accounts payable, cash disbursements, payroll, and fixed assets. Noted that a unique company code is established for each of the Section 272 affiliates and is required for all transactions. Also noted, through inquiry, that access to the Section 272 affiliates' company codes is restricted to authorized users within the Section 272 affiliates' and SBC Services, Inc.'s organizations. The Section 272 affiliates follow the accounting practices used by the other SBC non-incumbent local exchange carrier affiliate companies. Noted **through** inquiry that the Section 272 affiliates do not maintain written accounting procedures and policies related to the financial systems noted above.

Noted per review of supporting documentation that SBC has formalized its accounting procedures and policies in a set of Operating Procedures ("OPs"). Section 10.502 of OP 6 includes a description of the requirements and restrictions applicable to transactions with the Section 272 affiliates as specified in Section 272 of the Act. As any procurement activity by an SBC BOC from a Section 272 affiliate would result in an affiliate transaction, OP 6 refers to OP 125 – *"Nontariffed Activities and affiliate Transactions,"* for complete instructions on affiliate transactions. SBC has established written controls to require any SBC BOC purchase from a Section 272 affiliate comply with Section 272, including the SBC BOCs' nondiscriminatory procurement obligations. The internal control in place is that any nontariffed affiliate transaction must be approved by the Affiliate Oversight Group prior to the purchase; additionally, the approval process includes a review of the SBC BOCs' nondiscrimination obligations.

3. Obtained a list of all collections from the sale of the Section 272 affiliates' trade accounts receivable to other SBC affiliates for the month ended March 31, 2001. Receivables are sold to the SBC BOCs with recourse back to the Section 272 affiliates for uncollectible accounts. Verified that collection of the trade accounts receivable was reflected in the accounts of each Section 272 affiliate by tracing the collections to each Section 272 affiliate's general ledger without exception.

For the month ended March 31, 2001, randomly selected 10 cash disbursements and five payroll transactions for each Section 272 affiliate and verified that the selected transactions were funded by and appropriately reflected in the general ledger of each Section 272 affiliate by tracing these transactions to the Section 272 affiliate's general ledger without exception. Traced the selected cash disbursements to the March 2001 bank statements for each Section 272 affiliate.

Documented the process for how each Section 272 affiliate receives credit for collections and how each Section 272 affiliate funds payments processed on its behalf through the SBC Services, Inc. affiliate. All transactions for each of the Section 272 affiliates and any

other SBC affiliate are funded ~~through~~ the consolidated cash management process in which ~~an~~ intercompany note payable/receivable is established each month by SBC for each of the affiliates. The note funds intercompany transactions and transactions with third parties that are disbursed ~~through~~ the applicable Section 272 affiliate bank account. Each of the Section 272 affiliates has zero balance bank accounts (“ZBAs”). SBC funds the ZBAs on a daily basis as checks clear and records an increase in the note receivable balance on its general ledger due from the Section 272 affiliate. The Section 272 affiliate records a corresponding increase to the note payable to SBC on its general ledger. Reductions to the note are made at such times that cash collections, intercompany receivables, and equity infusions are made to the Section 272 affiliate. Receipts from direct billings and billings through the SBC BOCs for the Section 272 affiliates are deposited in central lockboxes maintained by the Section 272 affiliates. These amounts reduce the note payable balances on the Section 272 affiliates’ books, reducing the ~~amount~~ owed to SBC.

Intercompany transactions are recorded on SBC’s Treasury Intercompany Payment System (“TIPS”), which was developed internally by SBC.

4. Obtained each Section 272 affiliate’s financial statements as of March 31, 2001 and a listing of all lease agreements, including the associated annualized payments or receipts in effect during the Engagement Period. Identified, in the workpapers only, five ACI leases and one SBCS lease that had annual payments or receipts of \$500,000 or more during the first nine months of the Engagement Period. Obtained copies of the five ACI leases and the SBCS lease identified above and noted that all leases selected for testing were appropriately recorded as operating leases in accordance with generally accepted accounting principles.

OBJECTIVE III. Determine whether the separate **affiliate** required under Section **272** of the Act has officers, directors, and employees that are separate from those of the **BOCs**.

1. Obtained SBC’s and the Section 272 affiliates’ policies and procedures for transferring, sharing, and loaning employees between each other and identified and documented the types of internal controls that were in place during the Engagement Period to prevent one from being an officer, or director, or employee of both an SBC BOC and a Section 272 affiliate at the **same** time. Noted, based on inspection, that these policies and procedures covered all SBC affiliates, including the SBC BOCs and the Section 272 affiliates. The policies and procedures provided by SBC are noted below:

Transfers

Noted that policies and procedures for employee transfers are specified in the business rules for recording employee status events in the payroll systems. These procedures require any employee “status changing” event, including movement or transfer between affiliates, to be documented by a Personnel Change Record (“PCR”) form. This form

requires that the payroll charging direction for a transferred employee is redirected to the “receiving” affiliate. The rules specifically advise that PCRs must be processed timely to provide that a transferred employee does not receive a paycheck from both a former and new employing affiliate.

Noted that SBC also has an automated approach to detect any errors occurring if PCRs are not processed timely or correctly. The SBC Human Resources Organization Service Center generates a weekly report that compares the social security numbers for all employees in the four payroll systems in use in SBC during the Engagement Period. This report is designed to compare the systems in order to verify that no employee is receiving pay from more than one affiliate within the four payroll systems.

Sharing & Loan of Employees

Noted that SBC policy prohibits the provision of any good or service between SBC BOCs and Section **272** affiliates that does not follow the FCC’s Accounting Safeguard rules. Also noted that the sharing and loan of employees not properly documented with a written agreement and compensated according to the FCC’s requirements would be prohibited by SBC policy. Noted that the SBC policy defines that any service provided by employees of either the SBC BOC or the Section **272** affiliate to the other would be deemed an affiliate transaction and would be structured under the provisions of OP **125** (described in response to Objectives V & VI, Procedure 2).

Officers/Directors

Noted that SBC’s policy defines officers as any individual that has been designated to hold a corporate office that has been authorized by the SBC BOCs’ or Section **272** affiliates’ (collectively referred to as “subsidiaries”) bylaws. Officers and directors are not required to be employees of the subsidiary. Noted that the policies, procedures, and internal controls for officers and directors are similar.

Noted that the internal control to prevent one from being an officer or director of both an SBC BOC and Section **272** affiliate is the manual review of each entity’s board and officer listings prior to effecting a change to the board of directors or officers of an affiliate. All subsidiary corporate memberships (directors and officers) are managed centrally through SBC’s Legal Department. The Legal Department is assigned to review all changes in the composition of the SBC BOCs and Section **272** affiliates for individuals active at both an SBC BOC and Section **272** affiliate.

Employees

Noted that there is an internal control to detect and prevent an employee’s “dual employment” with the SBC BOCs and the Section **272** affiliates which includes the company’s payroll systems’ built-in controls which prevent an employee from being paid from multiple affiliate payrolls within the **same** payroll system. Noted that although the company has multiple payroll systems, employees continue to be paid

through their original payroll system, regardless of which affiliate they subsequently transfer to. The current employing affiliate always recognizes the employee's payroll expense.

In addition, also noted that supplemental controls include paycheck/advice distribution through the employee's supervisor (or designate), rather than directly from the payroll organization to the employee.

SBC disclosed during the June through August **2000** timeframe three employees who transferred from an SBC BOC to ACI reported for duty to ACI prior to or after their transfer effective date and were requested to return to their former posts to train their successors. According to the ACI transfer policy, employees are not to begin work in their new positions until their effective payroll date and should not perform services in their old positions on or after the effective date. SBC represented that procedures were put in place during third quarter **2000** to improve the employee transfer policy at ACI. Additionally, the employee transfer policy was covered with the ACI leadership team during September 2000.

2. Inquired of SBC and documented that the Section **272** affiliates and the SBC BOCs maintain separate boards of directors and separate officers. For each SBC BOC and Section **272** affiliate, reviewed the minutes of the board of directors meetings held during the Engagement Period. Obtained a list of the names of officers and directors of the SBC BOCs and Section **272** affiliates, including the dates of service for each officer and/or board member for the Engagement Period. Compared the list of officers and directors of the SBC BOCs with the list of officers and directors of the Section **272** affiliates, and noted no officers or directors simultaneously on both lists.

Read the minutes of the meetings of the boards of directors in which the boards of directors were elected for each Section **272** affiliate and each SBC BOC. Noted no individuals served as a director or officer of an SBC BOC or a Section **272** affiliate at the same time.

3. Obtained the functional organizational chart for each Section **272** affiliate as of March 31, **2001**. Inspected the functional organizational charts and noted no departments reporting either functionally or administratively (directly or indirectly) to an officer of an SBC BOC. In addition, SBC represented that no department of the Section **272** affiliates reported either directly or indirectly to an officer of an SBC BOC.
4. Obtained the payroll registers for each Section **272** affiliate that included the social security numbers of all the directors, officers, and employees as of March 31, **2001** and designed and executed a program which electronically compared the social security numbers of directors, officers, and employees on the Section **272** affiliates' payroll registers to the electronic employee records for the SBC BOCs. Noted that four

		Number of Duplicates
ACI	Illinois Bell	3
ACI	Wisconsin Bell	1

6. Obtained the lists of employees of the Section 272 affiliates from February 8, 1996 through March 31, 2001. Selected a random sample of 100 employees from the lists obtained and inspected SBC's personnel files which indicated the employee's employment history within the SBC BOC family of companies. Noted that of the 100 randomly selected employees, 19 ACI employees and four SBCS employees had also been employees of an SBC BOC or another affiliate during the period from February 8, 1996 through March 31, 2001. Documented at Attachment A-3 the number of employees and dates each person was employed by the SBC BOCs, any other affiliate, and the Section 272 affiliates since February 8, 1996. Noted no employees listed on Attachment A-3 that repeatedly transferred back and forth between the Section 272 affiliates, the SBC BOCs, and other affiliates.
7. Obtained the methodology used to calculate annual bonuses for officers and management employees of each Section 272 affiliate. Inquired and determined the methodology used is tied to the combined results of the Section 272 affiliates and the SBC BOCs. Noted that management bonus rates were based on "Network Services" financial results that include the results of the SBC BOCs, the Section 272 affiliates, and other wireline affiliates. Noted that the actual team payout ratio for 2000 was 50% compared to the target team payout of 100%.

Obtained the actual calculations used to determine the annual bonuses paid to all officers and senior managers and a representative sample of 25 middle and lower level managers. Recalculated the bonuses using the methodology provided by SBC and agreed the bonus amount to the applicable payroll register for payment to each individual.

OBJECTIVE IV. Determine that the separate affiliate required under Section 272 of the Act has not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the **BOCs**.

1. Documented, in the workpapers, that the Section 272 affiliates had no debt agreements/instruments or credit arrangements with unaffiliated lenders and major suppliers of goods and services in effect during the Engagement Period.

Documented that SBC Communications Inc. and Ameritech Corporation, the "holding companies," extended credit to the Section 272 affiliates **through** the consolidated cash management process.

2. Using the lease agreements obtained in Objective II, Procedure 4 (those exceeding \$500,000), documented that there were no instances in which a Section 272 affiliate's lease agreement had recourse to an SBC BOC's assets either directly or indirectly through another affiliate.

3. Requested positive written confirmation from the Section 272 affiliates' lessors for all leases with unaffiliated entities with annual payments in excess of \$500,000 (one SBCS lease and two ACI leases) and for 10 leases judgmentally selected with annual payments less than \$500,000. Received responses from eight out of 13 requests sent; the responses confirmed that there was no recourse either directly or indirectly to the assets of any of the SBC BOCs. For one ACI lease with annual payments in excess of \$500,000, received a response indicating that the lessor would not respond to a confirmation request.
4. Obtained documentation and noted the balance of accounts payable (receivable) of each Section 272 affiliate to (from) and/or advances from (to) the SBC BOCs as of March 31, 2001 as follows:

Table 3

	ACI	SBCS
Ameritech Illinois	\$ (206,590)	\$ —
Ameritech Indiana	1,603	—
Ameritech Ohio	4,484	—
Ameritech Michigan	5,619	—
Ameritech Wisconsin	8,925	—
SWBT	—	11,162,162
SNET	17,795	—
Pacific Bell	14,772	388,876
Nevada Bell	—	—
Total payable (receivable) to (from) SBC BOCs	<u>\$ (153,392)</u>	<u>\$ 11,551,038</u>

OBJECTIVE V. Determine whether the separate affiliate required under Section 272 of the Act has conducted all transactions with the BOCs on an arm's length basis with the transactions reduced to writing and available for public inspection.

OBJECTIVE VI. Determine whether or not the BOCs have accounted for all transactions with the separate affiliate in accordance with the accounting principles and rules approved by the Commission.

1. Documented, as follows, the procedures used by the SBC BOCs to identify, track, respond to, and take corrective action to competitors' complaints relating to alleged violations of the Section 272 Requirements.

SBC represented that the following procedures were used by the SBC BOCs to identify, track, and respond to complaints relating to alleged violations of the Section 272 Requirements during the Engagement Period. The SBC BOCs have assigned a point of contact for competitors' complaints through their respective Industry Markets Account

Team (“Account Team”) or the Access Service Office. The Account Team is responsible for conducting an appropriate investigation and/or taking appropriate action for resolution of all complaints. If the competitors are not satisfied with the resolution of the complaint, they may escalate their complaint to a higher level of management within SBC. This escalation process is in place to provide a forum to respond to the competitors’ issues/concerns, which ultimately may be addressed or resolved at an officer level (i.e., President – Industry Markets). Competitors not satisfied with the resolution of their concern/complaint may at their discretion file a complaint with an appropriate regulatory agency. Each SBC BOC has designated representatives in its state regulatory groups to address both formal and informal complaints lodged with the corresponding state regulatory commissions. In addition, SBC has assigned representatives within its Federal Regulatory group to address FCC formal and informal complaints. Finally, SBC has established a **272** Compliance Team, including representatives from each SBC organization, group, business unit, etc. affected, or potentially affected, by the Section **272** Requirements, to address any Section **272** related issues and complaints.

Obtained from the SBC BOCs a list of all FCC formal complaints, as defined in **47 CFR 1.720**; FCC informal complaints, as defined in **47 CFR 1.716**; and any written complaints made to a state regulatory commission from competitors filed during the first nine months of the Engagement Period involving alleged noncompliance with the Section **272** Requirements, including complaints submitted by competitors related to the provision or procurement of goods, services, facilities, and information, or in connection with the establishment of standards.

- Allegations of cross-subsidies (**no Complaints received**)
2. Obtained from the SBC BOCs and each Section **272** affiliate current Written procedures for transactions with affiliates and compared these procedures with the FCC Rules and Regulations, including Sections **32.27**, **53.203(e)**, and **64.901**; Paras. 122, **137**, **183**, and **265** of the *Report and Order* in CC Docket No. **96-150**, issued December **24**, **1996**, concerning Accounting Safeguards Under the Telecommunications Act of 1996 (11 FCC Rcd **17539** (1996)); and Paras. **180**, **193**, and **218** of the *First Report and Order and Further Notice of Proposed Rulemaking* in CC Docket No. **96-149**, issued December **24**, **1996**, concerning Non-Accounting Safeguards under Sections **271** and **272** of the Act. Noted that the SBC BOCs’ written policies and procedures did not address the certification statement required by CC Docket **96-150**, paragraph **122**.
 3. Inquired and documented how the SBC BOCs and each Section **272** affiliate disseminate the FCC Rules and Regulations by noting that the SBC **272** Oversight Team, operating at the parent company level, has overall responsibility to coordinate dissemination of the obligations created by the Section **272** Requirements across the entire company including both the SBC BOCs and the Section **272** affiliates. At the corporate level, SBC represented that the **272** Oversight Team established a **272** compliance web site and

posted various training and reference materials on an Intranet site. **SBC** represented that the **272** Oversight Team has designated a training coordinator for each impacted business unit.

The following **types** and frequency of training were noted

SBC BOCs:

SBC represented that the training provided by the **SBC BOCs** addressed key topics such as what services could be provided to the Section **272** affiliates, the required terms and conditions for providing services, the protection of proprietary information, and permitted and prohibited activities when performing joint marketing. Managers with a need to know were provided with training on Section **272** issues.

SBC represented that the **SBC BOCs** developed numerous documents containing the Methods and Procedures (“M&P”) associated with the Section **272** long distance approval. M&P were a primary training tool to require that employees performed specific business procedures in compliance with the Section **272** Requirements.

In addition, **SBC** represented that employees of the **SBC BOCs** and the Section **272** affiliates attended training presented by the **272** Oversight Team. This training was presented in live sessions at various company locations in **2000** and 2001.

SBC represented that the **272** Oversight Team also made training materials available to employees of the **SBC BOCs** and Section **272** affiliates via the Intranet. **SBC** maintained an Intranet site with various training materials and on-line courses available to all employees.

SBC represented that frequency of the training was focused on initial training once the Section **272** affiliate had obtained long distance approval. **SBC** represented that frequency of refresher training will be determined in 2001.

Section 272 affiliates:

The Section **272** affiliates were designed and organized to be structurally **separate** from the **SBC BOCs**. Separate operating procedures were developed for the Section **272** affiliates’ business activities, and these procedures specifically addressed the restrictions and requirements on interaction with the **SBC BOCs**, as imposed by the Section **272** Requirements and other **FCC** rules. **SBC** represented that M&P at the Section **272** affiliates were designed pursuant to restrictions and requirements of the Section **272** Requirements. **SBC** represented that M&P were a primary training tool to require that employees performed specific business procedures in compliance with the Section **272** Requirements.

SBC policies related to Section 272 Requirements:

Code of Business Conduct

SBC represented that each SBC employee is expected to abide by the standards embodied in the SBC Code of Business Conduct. Toward this objective, all employees have the following responsibilities with regard to the Code's administration.

- Ensuring that each employee they supervise annually receives and reads a copy of the Code of Business Conduct and signs a copy of the Acknowledgment Form annually;
- Ensuring that employees are aware that they may make a good faith report of a violation or suspected violation of the law or the Code without fear of reprisals;
- Ensuring that any standards and procedures developed for their areas comply with the Code and are communicated to affected employees;
- Reporting any possible violations of the Code of Business Conduct and/or situations which could result in Code violations or be perceived as Code violations to higher level management.

Competition Guidelines

SBC represented that the Company's Competition Guidelines are supplemental to the Code of Business Conduct, and employees are required to review the Competition Guidelines every three years (annually in Texas) with the review documented in the employee's record.

Section 272 Employee Compliance Guide

SBC represented that the 272 Oversight Team developed an employee compliance guide specifically for SBC Section 272 Requirements. This guide is available to employees on the SBC Intranet web site. SBC also represented that upon obtaining Section 271 authorization in a particular SBC state, employees are provided with reminder notices of their obligations to comply with the Section 272 Requirements and are directed to refer to the Section 272 employee compliance guide.

Supervision of employees responsible for ensuring compliance with these rules:

SBC represented that the 272 Oversight Team defined responsibilities for each business unit to name a primary and secondary training contact. SBC represented that the role of the Primary Contact was to ensure that all of the business unit's employees are appropriately trained.

In addition, SBC represented that it also maintains a company-wide Section 272 Compliance Program which includes a designated Compliance Coordinator for each business unit. SBC represented that the Coordinator's responsibilities include training.

Interviewed those employees responsible for developing and recording in the books or records of the carrier transactions affected by these rules and noted that they were aware of the Section **272** Requirements and affiliate transaction rules. These employees included four employees from the Affiliate Oversight Group, two employees from Ameritech Services, Inc. responsible for recording Ameritech BOC transactions, **two** employees from SBC Services, Inc. responsible for recording SBC BOC transactions for SWBT, Pacific Bell, and Nevada Bell, and one employee responsible for Section **272** affiliate transactions.

4. Inquired and described the process that a Section **272** affiliate must follow to request any type of service from the SBC BOCs and the approval process within the SBC BOCs to fulfill a request for service from a Section **272** affiliate, noting that the Section **272** affiliate does not request services directly from the department that provides the service. The following **are** the steps in the request process that each Section **272** affiliate must follow:

The process for provision of services is as follows:

- Step 1: **An** affiliate agreement is in place prior to any transactions between an SBC BOC and a Section **272** affiliate.
- Step 2: A Section **272** affiliate contacts the Account Team representing the SBC BOC to request the service and describe the components of the request.
- Step 3: For services provided under ~~tariff~~ or prevailing price agreements, the Account Team completes the Section **272** affiliate's request for service.
- Step 4: For services provided under affiliate agreements, the SBC BOC determines whether a service can be offered to the Section **272** affiliate. The SBC BOC estimates the recurring and nonrecurring labor, expense, and capital required to provide the service to the Section **272** affiliate.
 - Step 4a: The Account Team negotiates with the SBC BOC and notifies the Section **272** affiliate whether the SBC BOC is willing to provide the service.
 - Step 4b: **An** affiliate agreement is drafted by the SBC BOC, signed by the SBC BOC, and sent to the Section **272** affiliate for signature.
 - Step 4c: Once the ~~affiliate~~ agreement has been signed by both parties, the contract is considered executed and the agreement and any applicable documents are posted on the SBC Internet site at <http://www.sbc.com/PublicPolicy/Regulatory>.

The approval process within the SBC BOCs to fulfill a request for service from a Section 272 affiliate is as follows:

- Step 1: The SBC BOC employees contact the Account Team regarding all requests related to the procurement of any affiliated SBC BOC good, service, facility, or information.
 - Step 2: All requests from a Section 272 affiliate are directed to the existing customer contact point appropriate for the service being requested.
 - Step 3: All other nontariffed proposed affiliate transactions are submitted to the Affiliate Oversight Group prior to the provision or receipt of any service.
 - Step 4: The Affiliate Oversight Group provides the final guidance and approval on which services can or cannot be provided to the Section 272 affiliate.
5. Obtained the written agreements for services provided under affiliate agreements and contracts between the SBC BOCs and the Section 272 affiliates that were in effect through March 31, 2001. SBC represented that services provided under tariff from the SBC BOCs to the Section 272 affiliates had no written agreement other than the applicable tariff. Copies of the tariffs were not obtained in this procedure. Included copies of the obtained agreements in the workpapers and noted names of parties, type of service, price, terms, and conditions. Compared these agreements with the list of services provided by the SBC BOCs to the Section 272 affiliates in Objective I, Procedure 4 and noted no exceptions.

In addition, noted those agreements still in effect, and for those agreements no longer in effect, indicated the termination date. Noted that three agreements between Illinois Bell and ACI, one agreement between Michigan Bell and ACI, and one agreement between SWBT and SBCS were terminated during the Engagement Period. SBC represented that no agreements were terminated prematurely during the Engagement Period because the service agreements between the SBC BOCs and the Section 272 affiliates are not term agreements. Inquired and documented that the SBC BOCs' policy is to not provision services to the Section 272 affiliates without a written agreement. SBC represented that none of the Section 272 affiliates obtained any services from an SBC BOC without a written agreement.

The affiliate agreements in effect as of March 31, 2001 were posted on the SBC Internet site at:

<http://www.sbc.com/PublicAffairs/PublicPolicy/Regulatory>

6. Viewed the SBC Internet site at <http://www.sbc.com/PublicAffairs/PublicPolicy> as of March 29, 2001 and noted that all agreements and pricing addendums, 450 in total, obtained in Procedure 5 above were posted on the Internet, except for 25 agreements or pricing addendums noted in Attachment A-4. Noted that there were no asset transfers between the Section 272 affiliates and the SBC BOCs included in the agreements obtained in Procedure 5 and no asset transfers were posted on the Internet as of March 29, 2001. SBC has represented that only furniture valued at \$5,000 was transferred from an SBC BOC to SBCS in 1996.

Table 4 – Summary Differences Between Agreements Posted on the Internet and the Agreements Located in the Central Files

Description	Number of Differences from Total Population of 450 Agreements and Pricing Addendums
Agreements or Pricing Addendums posted on the Internet at March 29, 2001, but not located in Central Files	17
Agreements or Pricing Addendums included in the Central Files, but not posted on the Internet at March 29, 2001	25

SBC BOC	Address	City, State
SWBT	530 McCullough	San Antonio, Texas
Nevada Bell	645 E. Plumb Lane, B120	Reno, Nevada
Pacific Bell	140 New Montgomery, 2501	San Francisco, California
SNET	310 Orange Street	New Haven, Connecticut